Press release:

New Hay Group Study Finds that Medical Premiums Continue Double-Digit Rise for Fifth Consecutive Year

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Employers see their fifth year of double-digit medical premium increases with an average increase of 10.5% in 2004. This is down from 2003, but still 3 times the inflation rate, with increases around 10% expected for 2005. Hay Group outlines prevalent cost containment strategies.

PHILADELPHIA, August 18, 2004: Medical premiums rose an average 10.5% in 2004 after plan reductions, according to the 2004 Hay Benefits Report, a cross-industry survey of over 1000 US companies. Although down from an average increase of 14% for 2003, the 2004 increase of 10.5% is sharply higher than the US Consumer Price Index of 3.3%. To make matters worse, medical premiums are expected to increase by about 10% again for 2005.

Stated in terms of payroll, employer costs for health benefits have risen steadily over the past four years from 7.28% in 2000 to 7.84% in 2002, and to 8.75% in 2004. Companies not able to absorb the medical cost increase this year or next would have to reduce medical benefits, reduce salary increases, reduce staff, or lower some other costs.

HMO and Point of Service (POS) plans, which require Primary Care Physician referrals for specialist visits and tests, have lower premium costs than Preferred Provider Organization (PPO) plans, which have no such requirement. Historically, HMO and POS plans have had lower cost increases due to the cost containment inherent in these required referrals. This pattern did not hold true for 2004. HMO premiums increased 14.75% and POS plan premiums increased 13.25% compared to 9.0% for PPO plans. This is probably due to HMO and POS plans easing up on approving referrals in response to litigation and consumer and government pressures.

EXPLORING CAUSES FOR CONTINUING RISING MEDICAL PREMIUMS' COSTS

Medical costs have been rising for a number of reasons. One reason is that reimbursement

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rates to hospitals and physicians are on the rise. In the second half of the 1990s, HMO and PPO plans held down reimbursement rates to the point where healthcare providers took action to gain increases. For example, hospitals have been merging into larger systems, sometimes with physician networks, giving them more bargaining power in their negotiations with insurers.

Another cause of rising medical costs is continuously improving medical technology, which allows very sick people to live longer, and incur significant medical expenses. Prescription drug costs increasing at a rate exceeding 15% are another cause of rising medical expenses. Other factors include the aging of the workforce and the fact that Americans have become increasingly less healthy, especially in the areas of weight, diabetes, and heart disease.

"This is a very difficult time for companies to cope with double-digit medical premium rate increases," says Michael Carter, Vice President in Hay Group's benefits practice. "In the current business environment, most companies simply cannot afford to pass these costs along to their customers." As a result, to maintain current levels of profitability, companies are likely faced with shifting medical costs to employees, exploring new strategies to contain rising medical costs, as well as cutting costs in other areas.

"There is no one 'silver bullet' solution to contain medical costs, so companies must use multiple strategies," says Hay Group's Carter. He adds that "the longer companies wait to address the issue, the more painful it could be for them or their employees."

EMPLOYEES FACE INCREASED COSTS

One strategy is to shift more costs to employees. Many companies pay a fixed percentage of the premium, so when average premiums rise 10%, then employees' costs rise 10%. In addition, companies have been increasing employee deductibles, co-payments, and the limit at which employees' "out-of-pocket" expenses are capped.

One of the most striking changes in the last two years has been the increase in employee co-payments for doctor visits, with the number of plans with co-pays of $15 or more rising from 47% in 2002 to 72% in 2004. Moreover, 30% have co-pays of $20 or more in 2004.

Companies have also taken several actions in response to large increases in prescription drug costs. A common approach is to raise employees' co-payments. The typical co-pay for generic drugs doubled in the last two years from $5 to $10. Most of prescription plans now use a "formulary," a list of preferred lower-cost brand drugs with lower-dollar co-pays for employees than non-formulary brand drugs. The typical formulary co-pay is $20 in 2004, up from $10 two years ago, while the median non-formulary co-pay is $30 up from $15 two years ago.

In addition, one third of companies now require the use of lower-cost generic drugs if available, unless otherwise specified by the physician. The use of mail-order drugs for "maintenance" medication is also increasing in popularity (10% in 2004), as is the change from a fixed-dollar to a percentage-based co-payment (11% in 2004). This provides employees with more incentives to use generic and formulary drugs, and shifts part of drug cost increases to the employee.

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Historically, companies have provided "wellness" programs that include preventive exams, health programs such as smoking cessation, and health club membership, all aimed at improving employees' general health. Companies also have offered "case management" programs aimed at controlling costs of major illnesses.

Disease Management focuses on improving the health—and thus controlling the costs—of common manageable diseases. These include diabetes, asthma, congestive heart failure, coronary artery disease, and hypertension. These voluntary programs, now in place in most companies, are designed to prevent the state of the disease from advancing, and where possible, to result in an improvement.

Health Reimbursement Accounts (HRA) and Health Savings Accounts (HSA) along with "high deductible" plans are also emerging as a cost containment strategy. These new types of plans involve a company-funded HRA or employee or company-funded HSA that employees can use for IRS-approved health expenses—including some items not typically covered in medical plans. Unused amounts can be carried over to the following year, in theory encouraging employees to become better health care consumers. Supplementing the HRA/HSA is a "high-deductible" plan, with typical annual deductibles ranging from $1000 to $3000 per individual.

Eleven percent of companies report offering as an option an HRA, high-deductible plan, or both. Typical employee participation in these options is reported at less than 10%. New in 2004, less than 10% of companies are expected to adopt HSAs for 2005.

WHAT COMPANIES ARE DOING

In addition to the strategies described above, one strategy used by our clients is that of "employee consumerism." This involves communicating to employees how medical cost increases affect them (e.g., higher employee costs, lower pay increases, lower staffing levels) and what they can do about it (e.g., improve health, use Disease Management, use 24-hour medical assistance services, ask questions of your provider, check insurer charges). "Employee consumerism enables clients to enlist their employees in the battle to control health care costs," says Carter.

Other strategies used by Hay Group's clients include negotiating rate renewals, bidding out coverage, consolidating plans and funding methods, and (to a lesser extent) implementing "consumer driven" plans like HRAs with high-deductible plans.

WHAT'S IN STORE FOR 2005?

Looking ahead to plan changes for 2005, more cost shifting is likely. However, Hay Group's Carter cautions that "there is a limit to the amount that companies can shift costs to employees, particularly lower-paid employees." With the average annual employee premium contribution for family coverage reaching $2400 in 2004 and increasing co-payments, companies will need to rely on strategies other than cost shifting. "Disease Management, which lowers costs by improving employees' health, currently is the best long-term strategy for controlling costs," says Carter.

ABOUT THE HAY BENEFITS REPORT AND HAY GROUP

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Published annually for over 30 years, the Hay Benefits Report (HBR) contains extensive information about the design, cost, and trends of employee benefit plans, executive perquisites, and benefit-related personnel policies. Over 1000 organizations participated in the 2004 HBR, representing all industries and regions of the US.

Hay Group is a professional services firm that helps organizations worldwide get the most from their people by creating clarity, capability, and commitment. Founded in 1943 in Philadelphia, today Hay has 73 offices in 39 countries whose areas of expertise include: compensation, benefits, and performance management; executive remuneration; organizational effectiveness, role clarity, and work design; managerial and executive assessment, selection, and development; and customer and employee attitudes and behaviors.

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HMO Rates Continue Double-Digit Increases, But Begin To Moderate

Hewitt Data Shows U.S. Employers Remain Aggressive in Managing Costs Through Plan Design Changes and Higher Cost Sharing

LINCOLNSHIRE, Ill. -- Preliminary 2005 HMO rates will increase almost 14 percent, continuing a trend of double-digit health care cost increases, but are showing signs of moderation, according to new data from Hewitt Associates (NYSE: HEW), a global HR outsourcing and consulting firm.

As U.S. companies begin to negotiate health plan rates for 2005, data from the Hewitt Health Resource™ (HHR) -- a Web site that captures HMO rate information for nearly 160 large employers representing more than 1 million employees and annual premiums of nearly $4 billion -- shows that initial HMO rate increases are averaging 13.7 percent[1] compared to 17.5 percent at the same time last year. After plan changes, negotiations and terminations, the average HMO premium increased by 13.0 percent in 2004 (see charts for regional data).

"As we predicted last year, we're starting to see a moderation in health care premium increases, with the possibility of employers who aggressively manage their health care spending seeing increases in the single digits for the first time in five years," said Ken Sperling, East market leader for Hewitt's Health Management Practice. "The declining growth in HMO rates

reflects the fact that health plans have reached comfortable margins and are willing to price closer to their underlying costs."

2004 Summary

Despite cost moderation, companies are still facing double-digit increases and, as a result, continue to make plan design changes and share more of the cost with employees. For example, the number of companies offering a $20 office copay nearly doubled from 9 percent in 2003 to 16 percent in 2004. The number of organizations with a $15 office copay continues to increase in prevalence from 24 percent in 2002 to 47 percent in 2004. At the same time, employers offering $10 office copays continues to drop from 58 percent in 2002 to 29 percent in 2004.

"The work done by employers in past years is beginning to pay off in 2005," added Sperling. "The trend in health care cost increases has moderated due to stable hospital utilization rates, changes in prescription drug usage brought on by generic and over-the-counter alternatives, the positive impact of increased employee cost sharing on utilization rates, and an increased focus on disease management programs by employers."

Employees are also being asked to share more of the cost of prescription drugs (see chart below).

Percentage of Companies Offering Various Prescription Drug Option

Prescription Drug	2001	2002	2003	2004
Generic				
$5 co-pay	52%	46%	29%	28%
$10 co-pay	27%	40%	52%	50%
$15 co-pay			>1%	5%
Brand Formulary				
$10 co-pay	39%	28%	15%	12%
$15 co-pay	20%	30%	26%	20%
$20 co-pay	12%	26%	32%	33%
$30 co-pay			>1%	6%

Brand Non-Formulary				
$10 co-pay	13%	9%	7%	5%
$25 co-pay	16%	21%	8%	5%
$30 co-pay	11%	22%	19%	14%
>$30 co-pay	9%	24%	24%	38%
Drug Copayment Design				
1 tier	24%	15%	12%	12%
2 tier	32%	30%	24%	31%
3 tier	44%	55%	52%	49%

Specialty care office visit copays also continue to rise, with 35 percent of companies using a $15 copay, down from 40 percent in 2003, and 19 percent of companies are using a $20 copay, up from 12 percent in 2003. Sixteen percent of employers are introducing copays above $20. More than half (55 percent) of organizations currently use a $50 copay for emergency room visits, and 33 percent use a copay of more than $50, a significant increase from 16 percent in 2003 and only 7 percent in 2001.

"While this moderation in increases is good news for employers and employees, it's important to point out that employers and employees have endured years of double-digit increases, and health care continues to impact both corporate and individual pocketbooks," said Sperling. "Therefore, we expect companies to continue pursuing strategies that allow consumers to better manage their health and make smart choices about the health care services they consume."

About Hewitt Health Resource

Hewitt Health Resource is a Web-based service that helps companies manage all of their health plan interactions and data needs. HHR includes online capabilities for health plan selection and renewal, and Hewitt's Connections™ service for eligibility and premium management. To date, Hewitt has used HHR for 160 employers representing more than 1 million participants and nearly $4 billion in premiums. More than 120 health plans have also used the site.